

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re,
ANTHONY T. COCCIARDI,
Debtor.

Case No. 91-5-7664-MM
Chapter 11

MALCOLM G. WAITT, Successor Trustee,
and JANICE WAITT,
Plaintiffs,

Adversary No. 92-3127-LK/MM
Adversary No. 92-5160-MM

vs.

AMENDED MEMORANDUM OPINION

ANTHONY T. COCCIARDI,
Defendant.

I. INTRODUCTION

The matter before the Court is the trial to determine whether the debtor, Anthony Cocciardi, breached his fiduciary duty as trustee in connection with his administration of the Murl Eaton Trust and, if so, whether the liability arising from that breach should be non-dischargeable. Following eight days of trial, the Court concludes that in certain instances Cocciardi breached his fiduciary duty as trustee and is, therefore, liable to plaintiffs in the sum of \$609,597.17, which is non-dischargeable.

II. BACKGROUND

The subject trust is a testamentary trust established by Murl Eaton for the benefit of her son, William Eaton, during his lifetime with the remainder to his children, or, if he had no children, to his

1 brother and sister. Murl Eaton named Wells Fargo Bank as the institutional trustee of the trust, and
2 later substituted The Bank of California as trustee by a codicil. After Murl Eaton died in November
3 1972, her three children, William Eaton ("Eaton"), John Eaton, and Ann Leep, challenged the probate
4 of their mother's estate. As part of the settlement of the litigation, at Eaton's insistence and upon
5 agreement of John Eaton and Ann Leep, Anthony Cocciardi ("Cocciardi") was appointed trustee in
6 July 1976. Cocciardi testified that at the probate hearing, the estate's and Eaton's attorney, William
7 Christy, advised him to do "whatever Eaton wanted, because the trust funds were Eaton's money."

8 Cocciardi, not formally educated, grew up farming locally. As agriculture phased out, he
9 became a real estate investor and developer as well as a loan broker. Not infrequently, he took
10 second and third deeds of trust to secure loans. He also frequently did business on a handshake
11 among his circle of friends and acquaintances.

12 Cocciardi and Eaton became friends after Eaton purchased land from Cocciardi in the early
13 1960's. After Cocciardi showed Eaton a tract in Calaveras County, Eaton asked for a deposit slip
14 from Cocciardi. Thinking Eaton simply needed paper to write on, Cocciardi provided one to him.
15 Later, Eaton deposited \$35,000, the amount of the down payment, into Cocciardi's personal bank
16 account, apparently to test Cocciardi. When he discovered that Eaton had deposited the funds into
17 his bank account, Cocciardi returned the funds to Eaton. Thinking this was unusual behavior,
18 Cocciardi was skeptical about selling to Eaton. However, Eaton was insistent upon purchasing the
19 Calaveras property, so Cocciardi requested that the transaction go through escrow. Cocciardi earned
20 Eaton's trust as a man of integrity.

21 They had known one another for over ten years at the time Cocciardi was appointed as
22 trustee, and they maintained their friendship throughout Eaton's lifetime. They generally met several
23 times weekly over lunch to discuss investment opportunities. Cocciardi also kept Eaton apprised of
24 the status of trust investments. Both prior to and during Cocciardi's administration of the trust,
25 Cocciardi assisted Eaton with personal (non-trust) investments.

26 During the trial, witnesses variously described Eaton as eccentric, reclusive, physically
27 deformed, temperamental, opinionated, arrogant, generous, yet hateful towards his brother and sister.
28 However, the testimony also indicates that he was independent, intelligent, and college-educated,

1 with varied business investments. There is no evidence that Cocciardi exerted any undue influence
2 over Eaton.

3 The trust corpus originally consisted of a one-third undivided interest in the Silver Creek
4 Ranch, \$7,397.45 in cash, a one-third undivided interest in a promissory note, 760 shares of stock in
5 First National Bank valued at \$16,000, and, unknown to the parties at the time, a house on Foothill
6 Boulevard in Cupertino, California. The corpus was valued at almost \$400,000 at the trust's
7 inception in 1976.

8 The Foothill Boulevard home was inadvertently included in the trust corpus by a drafting
9 error. The evidence shows that it should have been conveyed to Eaton outright since Eaton had
10 personally purchased the home and conveyed it to his mother only because of his aversion, for
11 whatever reason, to holding title to real property in his own name. Immediately upon the
12 appointment of Cocciardi as trustee, Eaton, believing that he held title to his residence, quitclaimed
13 the house on Foothill Boulevard to Cocciardi. Eaton lived rent-free in the property for the remainder
14 of his life.

15 During his administration of the trust, Cocciardi periodically endorsed payments to the trust
16 directly to Eaton for his use with the understanding that the money was Eaton's. He kept no records
17 of such transactions. Eaton requested an accounting of trust receipts and disbursements only once.
18 Cocciardi responded to Eaton's request by retaining an accountant to prepare an accounting from the
19 bank statements, check stubs, and cancelled checks of the trust. Eaton was apparently satisfied and
20 never requested a more detailed accounting.

21 Six years prior to Eaton's death in 1989, he adopted an adult daughter to frustrate his mother's
22 intent that the remainder of the trust estate pass to his brother and sister. Eaton's brother and sister
23 relinquished their interests in the remainder to Eaton's adopted daughter as part of the settlement of
24 litigation in the probate court in which his brother and sister attacked the validity of the adoption.

25 The plaintiffs are Eaton's adopted daughter, Janice Waitt, and her husband, Malcolm Waitt
26 ("Plaintiffs"). Malcolm Waitt has been appointed as the successor trustee of the trust. Plaintiffs pray
27 that Cocciardi disgorge all profits generated since the inception of the trust, which they allege total \$8
28 million, whether the profits were realized by Cocciardi or by third parties. Secondly, they seek to

1 trace trust assets into Cocciardi's property and to impose a constructive trust on Cocciardi's assets.
2 The plaintiffs also seek punitive damages.

3 Cocciardi concedes the informality of his accounting during his administration of the trust and
4 agrees to reimburse the trust for all losses, but he asserts that he has always acted in good faith and
5 denies any intentional wrongdoing or malice. Cocciardi asserts that Eaton gave his informed consent
6 to the investments as well as to the form of the accountings.

7 III. DISCUSSION

8 A. Applicable Legal Standard

9 The Court's decision is grounded in the following established principles of probate law. As a
10 fiduciary, the trustee must act in the highest good faith towards the beneficiary, must make full
11 disclosure of material facts, must not acquire any adverse interest, or use his position to gain any
12 advantage over the beneficiary or to make any special profit. Werschull v. United California Bank,
13 85 Cal. App. 3d 981, 999-1002 (Cal. App. 1978). A trustee has the duty of loyalty to administer a
14 trust solely in the interest of the beneficiary. Cal. Prob. Code § 16002 (West 1991 & Supp. 1993).

15 The duty of loyalty encompasses the duty not to engage in self-dealing. A trustee may not use
16 trust property for the trustee's own profit. Morse v. Crocker Nat'l Bank, 142 Cal. App. 3d 228, 232
17 (Cal. App. 1983); In re Estate of Arbuckle, 98 Cal. App. 2d 562, 569 (Cal. App. 1950). For
18 example, pledging trust property for the benefit of the trustee is prohibited. California v. Larkin, 413
19 F. Supp. 978, 981-82 (N.D. Cal. 1976). A trustee also may not use trust property for the trustee's
20 own personal advantage. MacIsaac v. Pozzo, 81 Cal. App. 2d 278, 285 (Cal. App. 1947). "Personal
21 advantage" by the trustee may include some benefit, profit, favorable opportunity or improvement in
22 position derived from a transaction with the beneficiary. Ferrara v. La Sala, 186 Cal. App. 2d 263,
23 271-72 (Cal. App. 1960). However, the uncorroborated testimony of the fiduciary may be sufficient
24 to rebut the presumption of unfair advantage. In re Estate of Raphael, 115 Cal. App. 2d 525, 530
25 (Cal. App. 1953).

26 The current standard under California law is that a trustee must act with the same care, skill,
27 prudence, and diligence that a prudent person would use in the conduct of a similar enterprise. Cal.
28 Prob. Code § 16040. Section 16040 was enacted in 1986 to codify existing case law and supercedes

1 the former standard of "ordinary care and diligence" that a prudent person would exercise in the
2 management of his or her own affairs. Comment, Cal. Prob. Code § 16040; 11 Witkin, Summary of
3 California Law, Trusts §§ 79-80. The new "prudent person" standard is more stringent than the
4 former rule. See In re Estate of Collins, 72 Cal. App. 3d 663, 669 (Cal. App. 1977); Lynch v. John
5 Redfield, 9 Cal. App. 3d 293, 298-99 (Cal. App. 1970). The legislature did not indicate that this
6 elevated standard should be applied retroactively.

7 With respect to trust investments, the trustee has a duty to make the trust property productive
8 and to account for any gain realized from the use of trust funds. Cal. Prob. Code § 16007;
9 Petherbridge v. Prudential Savings & Loan Ass'n, 79 Cal. App. 3d 509, 517 (Cal. App. 1978); Marsh
10 v. Home Federal Savings and Loan Ass'n, 66 Cal. App. 3d 674, 684 (Cal. App. 1977). Section
11 16040 of the Probate Code provides that individual investments should be considered part of an
12 overall investment strategy. Cal. Prob. Code § 16040. This is the "portfolio approach" which allows
13 that a single bad investment might not constitute a breach of trust. Subsequent events should not be
14 considered when determining whether an investment was proper at the time it was made. Day v. First
15 Trust & Savings Bank, 47 Cal. App. 2d 470, 477 (Cal. App. 1941).

16 The trustee also has the duty to apply the full extent the trustee's skills. Cal. Prob. Code §
17 16014. In the absence of negligence or willful default, a trustee exercising judgment in good faith is
18 not liable for errors in judgment. Ainsa v. Mercantile Trust Co. of San Francisco, 174 Cal. 504, 510
19 (1917). A trustee is not expected to exercise infallible judgment in the investment of funds. Day v.
20 First Trust & Savings Bank, 47 Cal. App. 2d at 479. When buying a mortgage, a trustee should
21 investigate the status of the property and of the mortgage, as well as the financial situation of the
22 mortgagor, and give careful attention to the valuation of the property. In re Estate of Collins, 72 Cal.
23 App. 3d at 670. Ordinarily, second and third deeds of trust are not proper trust investments where
24 there is not an adequate margin of security. Id.

25 The criteria for determining whether a transaction should be characterized as a loan or as
26 some other type of investment for profit have been established under California law. A transaction is
27 more likely to be characterized as a loan where the recipient of the money grants a security interest in
28 property that he or she already owns. Giorgi v. Conradi, 199 Cal. App. 2d 82, 86 (Cal. App.

1 1962)(citing Batchelor v. Mandigo, 95 Cal. App. 2d 816, 823 (Cal. App. 1950). On the other hand,
2 the transaction is more likely to be characterized as a business venture where the money is used
3 entirely for the purchase of property not previously owned. Giorgi, 199 Cal. App. 2d at 86.
4 Ultimately, however, the facts of each case determine the form of the transaction. Id. at 85.

5 The trustee has numerous other specific duties. The trustee has a duty to take reasonable
6 steps under the circumstances to control and to preserve the trust property. Cal. Prob. Code § 16006;
7 Purdy v. Bank of America, 2 Cal. 2d. 298, 302 (1935). The trustee also has the duty to segregate
8 and designate trust funds. Cal. Prob. Code § 16009. If a trustee commingles trust funds, the trustee
9 is absolutely liable for presumed profits and legal interest even in the absence of actual fraud. In re
10 Stott's Estate, 52 Cal. 403 (1877). Withdrawals from a commingled account are also presumed to be
11 non-trust funds. Elmer Co. v. Kemp, 67 F.2d 948, 953-54 (9th Cir. 1934).

12 The trustee also has a duty to take reasonable steps to enforce claims by the trust and to
13 defend actions that may result in a loss to the trust. Cal. Prob. Code §§ 16010, 16011. The failure to
14 defend trust assets against adverse claims without justification subjects the trustee to liability for any
15 loss resulting to the trust. Metzenbaum v. Metzenbaum, 115 Cal. App. 2d 395, 399 (Cal. App.
16 1953).

17 Notwithstanding the foregoing standards for determining the liability of a trustee for breaches
18 of the standard of care, a beneficiary may relieve the trustee from liability by consent, release, or
19 affirmation. Cal. Prob. Code §§ 16463, 16464, 16465. For example, where the beneficiary is aware
20 of commingling of trust funds, the trustee's liability is limited to the trust's share of the proceeds of
21 investments. Title Ins. & Title Co. v. Ingersoll, 158 Cal. 474, 490 (1910). The mere fact that the
22 funds were commingled does not entitle the beneficiary to more than the trust's pro rata share. Id.
23 Also, where the beneficiary has the capacity to contract, has full knowledge of the trustee's motives
24 and all other facts regarding the transaction which might affect a decision, and has not been subject to
25 the trustee's influence, the trustee may personally transact business with the trust. In re Bauer's Trust,
26 17 Cal. App. 2d 426, 430 (Cal. App. 1936). However, the beneficiary's consent, release or
27 affirmation must be fully informed and not fraudulently induced. Cagnolatti v. Guinn, 140 Cal. App.
28 3d 42, 49 (Cal. App. 1983).

B. Remedies Available

If a trustee breaches a duty to the trust, the beneficiary has available under the Probate Code alternative remedies. Cal. Prob. C. § 16420; Edgar v. Bank of America, 50 Cal. App. 2d 827, 832-33 (Cal. App. 1942). The remedies against the trustee are exclusively in equity. Cal. Prob. C. § 16421. Remedies should remain flexible, as they are under common law, so that courts can fashion an appropriate response in particular circumstances. 11 Witkin, Summary of California Law, Trusts § 134 (9th ed. 1990). The Probate Code provides that the trustee's liability for damages, restitution, or surcharge are as follows:

(a) If the trustee commits a breach of trust, the trustee is chargeable with any of the following that is appropriate under the circumstances:

- (1) Any loss or depreciation in value of the trust resulting from the breach of trust, with interest.
- (2) Any profit made by the trustee through the breach of trust, with interest.
- (3) Any profit that would have accrued to the trust estate if the loss of profit is the result of the breach of trust.

Cal. Prob. Code § 16440(a). However, these remedies are not exclusive. Cal. Prob. Code § 16442.

Among the various ways to measure liability once a breach has occurred is for the trustee to account for the contract price of the transaction. Work v. County Nat'l Bankr & Trust Co. of Santa Barbara, 4 Cal. 2d 532, 536-37 (1935). A second measure of damages is for the beneficiary to recover the profits diverted to the trustee or a third party. Pierce v. Lyman, 1 Cal. App. 4th 1093, 1103 (Cal. App. 1991); Ariana v. Parker, 239 Cal. App. 2d 524, 531 (Cal. App. 1966). Another measure of damages is for the trustee to make good the amount of the loss of trust funds. In re Armstrong's Estate, 1 Cof. 157, aff'd, 69 Cal. 239, 10 P. 335 (1886); Pierce v. Lyman, 1 Cal. App. 4th at 1103. Yet another measure of damages is to hold the trustee accountable for the proceeds of the misapplied trust funds. Buffum v. Peter Barceloux Co., 289 U.S. 227, 236 (1933). The trustee is also liable for interest at the higher of the legal rate on judgments or the amount of interest actually received. Cal. Prob. Code § 16441. The matter of determining the

appropriate equitable relief to be accorded a beneficiary is left to the discretion of the court.

Rivero v. Thomas, 86 Cal. App. 2d 225, 238 (Cal. App. 1948).

Cal. Prob. Code § 16440 further provides:

(b) If the trustee has acted reasonably and in good faith under the circumstances as known to the trustee, the court, in its discretion, may excuse the trustee in whole or in part from liability under subdivision (a) if it would be equitable to do so.

Cal. Prob. Code § 16440(b). Notwithstanding the availability of these alternative remedies, the Court, at its discretion, may decline to impose any liability if the trustee acted in good faith.

The basic principle of liability for breach is that the injured beneficiary should be made whole, i.e., that the beneficiary should be restored to the same condition as if the wrong had not been committed. Witkin, supra at § 149. This standard affords the court broad discretion to fix the amount of the liability. In re Estate of Talbot, 141 Cal. App. 2d 309, 322-23 (Cal. App. 1956). Factors that the court should consider include: the good faith of the trustee; whether the trustee improperly sold or retained property, made an unauthorized investment, or failed to invest; whether there are allegations of fraud or self-dealing; and whether the loss is limited to income or includes the corpus. Witkin, supra at §§ 148-49.

Where a trustee breaches a fiduciary duty, equity may impress a trust for the benefit of the beneficiary on the profits arising from the transaction. Red Top Cab Co. v. Hanchett, 48 F.2d 236, 238 (N.D. Cal. 1931). Where trust property is converted and can be traced into other property, the trust may attach to the other property. Taber v. Bailey, 22 Cal. App. 617, 623 (Cal. App. 1913). A change in form does not divest a trust fund of its trust character. Republic Supply Co. v. Richfield Oil Co., 79 F.2d 375, 377 (9th Cir. 1935). However, to establish a constructive trust, the beneficiary must trace the trust funds to specific property. It is insufficient to show possession of the trust funds by the trustee and the subsequent purchase of property. Mitchell v. Dunn, 211 Cal. 129, 136 (1930).

To be entitled to an award of punitive damages, a plaintiff must show by clear and convincing evidence that the defendant acted with malice, fraud or oppression. Haigler v. Donnelly, 18 Cal. 2d 674, 681 (1941); Vale v. Union Bank, 88 Cal. App. 3d 330, 339 (Cal. App.

1 1979). Even if an award of exemplary damages were appropriate, exemplary damages are limited
2 to three times the amount of compensatory or restitutionary damages awarded. 11 Witkin,
3 Summary of California Law Trusts § 23 (9th ed. 1990).

4 C. Analysis of Trust Transactions

5 Applying the foregoing well-accepted principles of probate law to the following trust
6 transactions, the Court concludes that Cocciardi must be accountable to the trust for the amount
7 of the loss of trust funds. His liability arises because of the conceded informality with which
8 Cocciardi invested the trust funds and what Cocciardi's counsel characterized as "abysmal"
9 bookkeeping, as well as the failure to enforce claims by the trust and the high degree of risk in
10 certain of the trust transactions. However, the facts and the equities do not support either the
11 imposition of a constructive trust or an award of damages in excess of the amount necessary to
12 make the trust whole. The Court finds that Cocciardi's testimony about his relationship with
13 Eaton was credible and that he acted at all times in good faith while responding to the wishes of
14 the beneficiary. The evidence does not support any inference that Cocciardi embezzled trust
15 funds or deliberately obfuscated or failed to disclose information to the beneficiary. Plaintiffs'
16 allegations of fraud, non-disclosure, and malfeasance are based on nothing more than innuendo,
17 speculation, and inference. Notwithstanding Cocciardi's failure to comport with the highest
18 standards of a fiduciary, this is clearly not an appropriate case for an award of exemplary
19 damages. Plaintiffs have failed to establish by clear and convincing evidence that Cocciardi acted
20 with malice, fraud, or oppression.

21 In determining the amount of damages, the Court awards the trust principal plus interest at
22 the contract rate or, if there is no contract, at the legal rate from the time of default until the time
23 of judgment where there has been a loss to the trust. For purposes of this Memorandum Opinion,
24 the Court has computed the amount of interest payable to the trust through May 31, 1993.
25 Where there is an ambiguity or conflict in the evidence, the Court has applied the higher rate of
26 interest because presumptions are against the trustee for the failure to keep full and accurate
27 accounts. Blackmon v. Hale, 1 Cal. 3d 548, 559 (1970). Often, the rate applied is higher than the
28 prevailing market rate for the period that interest was accruing. The damages awarded are

sufficient not only to compensate the trust, but also to censure the trustee's conduct.

In the following transactions, the plaintiffs allege that Cocciardi misused trust assets.

1. Proceeds from the Sale of Silver Creek Ranch

The first transaction at issue relates to the disposition of the proceeds from the sale of the Silver Creek Ranch in May 1979. The trust received \$41,763 in cash from the sale of Silver Creek Ranch based on its undivided one-third interest in the property. Cocciardi deposited the cash proceeds into a six-month certificate of deposit at Wells Fargo Bank where both Eaton and Cocciardi maintained personal accounts. When the CD matured, Cocciardi transferred the principal and interest into the trust account at Sumitomo Bank.

Plaintiffs allege that Cocciardi deposited the funds in Wells Fargo Bank in order to have sufficient compensating balances to secure a \$90,000 personal loan from Wells Fargo Bank so as to acquire the property at 104 and 106 Holiday Drive, La Selva Beach (the "La Selva Beach Property"). They further argue that the trust is, therefore, entitled to a constructive trust on the La Selva Beach Property, which is now worth \$5 million. However, Gary Teasdale, a former officer of Wells Fargo Bank testified that at the time the trust funds were on deposit, Cocciardi had a line of credit with Wells Fargo of approximately \$400,000 that was available for the purchase of the La Selva Beach Property. The evidence fails to substantiate Plaintiffs' allegations. The Court finds the plaintiffs' claims are overreaching and avaricious as they appear to have no basis in fact. Even if the trust deposit at Wells Fargo Bank had been helpful to Cocciardi personally, case law does not support the result sought by the plaintiffs. See, e.g., Steen v. Hendy, 103 Cal. 15 (1894)(where a person of substantial means and good credit uses in business a relatively small amount of trust funds to which that person has access, the resulting profits are not attributable to the trust, and the trust is entitled only to interest for the use of the funds).

Also in support of their constructive trust theory, Plaintiffs introduced evidence that the trust paid \$3,500 to Rinaldi Tile in April 1986, suggesting that Cocciardi purchased tile for installation and personal use at 104 Holiday. The allegations are based on nothing more than innuendo. Cocciardi and his daughter, Caroline Cocciardi Eitzen, credibly testified that the tile purchased by the trust was not used for improvements to any of Cocciardi's property, but rather

1 for some unknown purpose of Eaton's. The Court wholly rejects the Plaintiffs' efforts to impose a
2 constructive trust on the La Selva Beach Property. As a result, Plaintiffs are not entitled to any
3 recovery from the trustee on this transaction.

4 **2. Siraky Loan**

5 The trust loaned \$27,000 to Ferenc Siraky, who was acquainted with Eaton, in December
6 1979. The transaction was documented by a promissory note, a deed of trust and a title insurance
7 policy. Cocciardi testified that the interest rate charged on this transaction was 12%. Siraky
8 made sporadic principal and interest payments during the term of the loan. Cocciardi testified that
9 he endorsed some of these payments directly to Eaton, and his testimony was credible. Siraky
10 repaid \$20,000 of the principal in September 1990. It is undisputed that Siraky failed to repay
11 \$3,000 in principal to the trust; however, interest also remained unpaid, and the plaintiffs dispute
12 the interest rate charged on the transaction based on the amounts of the payments. Cocciardi has
13 agreed to repay the trust \$3,000 principal plus interest from September 1990. The Court finds
14 that 19%, the higher rate asserted by Plaintiffs, is the appropriate interest rate to charge because
15 ambiguities are to be construed against the trustee. Blackmon v. Hale, 1 Cal. 3d at 559. This
16 results in a total recovery on this transaction of \$4,520, which includes \$1,520 in interest from
17 September 1990, the date of the last principal payment, through May 1993.

18 **3. Russo Loan**

19 The trust loaned \$20,000 to Albert Russo, who was acquainted with Eaton, in January
20 1980. The transaction was documented by a promissory note and a deed of trust that was
21 recorded four months later. Cocciardi testified that the interest rate charged on this transaction
22 was 10%. It is undisputed that by August 1980, Russo repaid the trust the entire principal
23 amount, but the plaintiffs dispute the interest rate charged on this transaction. The Court
24 concludes that the rate of interest to be paid on the Russo Loan is 17%, the higher of the amounts
25 alleged by the parties, again, because Cocciardi failed to document it properly and because
26 ambiguities are to be construed against the trustee. At the 17% rate, \$1,983.33 in interest was
27 due the trust at the time the principal was repaid. Russo paid the trust only \$1,333.34 interest on
28 this transaction. The unpaid interest of \$650, plus interest thereon of \$1,408.86 at 17% from

1 August 1980 through May 1993, results in a total recovery of \$2,058.86 on this transaction.

2 Cocciardi is liable to the trust for the balance of unpaid interest in the amount of \$2,058.86.

3 **4. Purchase from Cocciardi Corporation of Ashram Note Secured by**
4 **Rollingdell Property**

5 In May 1980, the trust purchased a \$39,000 promissory note from Ashram, Inc. payable to
6 Cocciardi Corporation and secured by a deed of trust in Mark Eitzen's Rollingdell property. The
7 trust was repaid the entire principal amount and interest in the amount of \$855 after two and a
8 half months.

9 The Plaintiffs assert that the purchase of the Ashram note facilitated a collateral property
10 exchange transaction involving Cocciardi, Ashram, and Eitzen, who is now Cocciardi's son-in-
11 law, resulting in a profit realized by Eitzen. They further allege that Cocciardi should be liable to
12 the trust for \$324,148, the amount of the profit that ultimately flowed to Eitzen, including
13 interest.

14 The Court declines to find that this transaction was a misuse of trust funds. The evidence
15 simply does not support Plaintiffs' argument that this transaction was anything other than the
16 purchase of a secured note with the expectation of a return to the trust upon maturity of the note.
17 The trust received principal and interest at 10.5%, which is a fair rate of return, within a
18 reasonable time. Thus, the plaintiffs are not entitled to any further recovery from Cocciardi on
19 this transaction.

20 **5. Martinez Loans**

21 **a. \$35,000 Loan**

22 In July 1980, the trust loaned \$35,000 to Oscar Martinez. The loan was secured by a
23 junior deed of trust on real property located on Quito Road. Cocciardi testified that the interest
24 rate charged on this loan was 12%. The loan went into default and Cocciardi ultimately was able
25 to recoup the principal of the loan in September 1983 but not the interest. Because investment in
26 junior deeds of trust involves high risk and because the trustee has a duty to enforce trust claims,
27 Cocciardi is liable to the trust for the unpaid interest of \$13,650 due as of September 1983, plus
28 interest thereon of \$15,834 at 12%, which results in a total recovery of \$29,484 on this

transaction.

b. \$29,000 Loan

The trust also loaned an additional \$29,000 at 17% interest to Martinez in March 1981. Martinez executed a \$33,000 note secured by a deed of trust on property on Vanderbilt owned by Martinez's sister. When the loan became troubled, Cocciardi sold the \$33,000 note for \$36,942.71 in April 1983. Only \$34,942.71 was deposited into the trust account because of an inadvertent oversight.

Plaintiffs argue that Cocciardi received an additional \$10,000 principal payment from Martinez because of judicial findings made in unrelated litigation. Cocciardi testified that he did not receive a \$10,000 payment from Martinez on this particular loan, and the Court finds his testimony credible. Cocciardi is liable only for the balance of \$2,000 received from the sale of the note, plus interest of \$3,428.33 at the contract rate of 17% from April 1983, which results in a total recovery of \$5,428.33 on this transaction.

6. Bryce Transaction

In May 1983, the trust purchased a \$25,000 third deed of trust for the discounted price of \$15,050. This was a troubled loan on which Cocciardi thought the trust could realize a \$9,000 profit. Eaton approved of the transaction. After the purchase by the trust, Cocciardi personally serviced the debt on the first and second deeds of trust while he looked for a buyer for the property. The trust eventually foreclosed on the deed of trust and sold the property in April 1986 for \$134,318.28. According to the escrow documents, the net proceeds of sale were \$33,309.

Only \$16,015 was repaid to the trust after Cocciardi reimbursed himself from the sales proceeds for his expenses in maintaining the property and for debt service on the senior trust deeds.

Although a trustee is entitled to reimbursement for expenses properly incurred in the administration of the trust, Cal. Prob C. § 15684; Petherbridge, 79 Cal. App. 3d at 517, the issue is not relevant here. The Court finds that this was an imprudent investment and that the trust should be reimbursed the principal and interest. As a result, Cocciardi is liable to the trust for the \$3,424.50 balance still owed to the trust as of April 1986 and interest thereon of \$2,425.69 at the legal rate of 10% from April 1986, which results in a total recovery of \$5,850.19 on this

transaction.

7. McAlpine Transactions

a. Purchase of Herzer Note

In May 1983, the trust purchased a \$68,500 note made by Randy McAlpine, who was an acquaintance of Cocciardi's, and the trust reduced the interest rate from 18% to 12%. The note was secured by McAlpine's Golfview property. In October 1985, McAlpine repaid the trust \$82,000, \$67,000 of principal and \$15,000 in interest, from the proceeds of the sale of McAlpine's McLaughlin Avenue property after again renegotiating the total amount of the debt. It is undisputed that McAlpine underpaid the trust by \$6,365 in principal and interest. Because Cocciardi had a duty to pursue trust claims, and the renegotiations do not appear to be in the best interest of the trust, Cocciardi is liable for the underpayment, with interest of \$5,792.15 at 12% from October 1985, which results in a total recovery of \$12,157.15 on this transaction.

b. \$22,000 Loan

In April 1985, the trust loaned McAlpine an additional \$22,000 on an unsecured basis. Cocciardi testified that he did not think that security was necessary for the trust because Cocciardi had taken title to the McLaughlin Avenue property in order to procure a loan on the property from Wells Fargo Bank using Cocciardi's good credit rating. Although McAlpine repaid Cocciardi for other loans, he failed to repay the loan from the trust as part of a global compromise. The trustee is liable for this omission because it was imprudent to make an unsecured loan and because the trustee has the duty to enforce trust claims. Cocciardi's liability on this loan, including interest of \$21,340 at 12%, the same rate as the other McAlpine transaction, from April 1985, which results in a total recovery of \$43,340 on this transaction.

8. Ward Transactions

a. \$9,420 Loan

In January 1985, the trust made an unsecured loan of \$9,420 to Richard Ward. The proceeds of the loan enabled Ward to complete a lot split and to sell the two lots separately. Ward failed to repay the trust. Plaintiffs argue that they are entitled to the \$236,000 profit that

1 Ward realized. However, neither the facts nor the equities support this result as this appears to be
2 an arm's length transaction. However, because it was imprudent to make an unsecured loan and
3 not pursue collection, the Court finds that Cocciardi is liable to the trust for the return of \$9,420
4 principal, plus interest of \$11,775 at 15%, the same rate as the second Ward loan, from January
5 1985, which results in a total recovery of \$21,195 on this transaction.

6 **b. \$16,500 Loan**

7 In March 1986, the trust made a second loan of \$16,500 to Ward at the interest rate of
8 15%. The loan was secured by Ward's property on Blauer Lane. Ward repaid the trust
9 \$19,435.80 in July 1987, but Cocciardi failed to deposit the funds in the trust account because of
10 an oversight. As trustee, Cocciardi is liable to the trust for the entire \$19,800 and interest of
11 \$17,325 at the contract rate of 15% from July 1987, which results in a total recovery of \$37,125
12 on this transaction.

13 **9. Bloch Transactions**

14 **a. \$10,000 Loan**

15 In May 1985, the trust made an unsecured loan of \$10,000 to Paul Bloch, who was an
16 acquaintance of Eaton's who was incarcerated after the loan was made. Plaintiffs allege that the
17 loan proceeds were used in Cocciardi's purchase of the Russell Street property from Bloch in July
18 1985, but the evidence fails to support this speculation. The evidence does not support an
19 interpretation of this transaction as anything other than a loan made in good faith. However, since
20 Bloch failed to repay the trust and because it was not prudent to make an unsecured loan and not
21 pursue collection, Cocciardi is liable to repay the principal and interest of \$8,000 at the legal rate
22 of 10% from May 1985, which results in a total recovery of \$18,000 on this transaction.

23 **b. \$43,000 Loan**

24 In October 1985, the trust made another loan of \$43,000 to Bloch, which was also not
25 repaid. Cocciardi testified that it was an unsecured loan at the interest rate of 13%. At the time,
26 Cocciardi held a \$100,000 deed of trust on Bloch's Palomares property. When Bloch defaulted
27 on his obligation to Cocciardi, Cocciardi foreclosed on the Palomares property and subsequently
28 resold it in August 1986 for \$200,000. The trust is entitled to 30% of the \$200,000 sales

proceeds because it contributed \$43,000 of the total of \$143,000 that was invested in the Palomares property. Cocciardi is liable for \$60,000, plus interest of \$52,650 at 13% from August 1986, which results in a total recovery of \$112,650 on this transaction.

c. Second \$43,000 Loan

In November 1985, the trust made a second loan for \$43,000 to Bloch. Both this loan and a \$37,000 loan from another Cocciardi investor were secured by a single deed of trust for \$80,000 in Bloch's Mission Street property in Hayward. Upon default, Cocciardi foreclosed on the deed of trust on the Mission Street property in September 1986 and ultimately traded the property for a comparable property in Santa Clara owned by Verda Fisher. Cocciardi sold the Fisher property in October 1986 for \$173,635.12. The trust was not repaid the \$43,000 loan from the sales proceeds. Cocciardi incurred additional obligations in the property exchange transaction, but these obligations will not be imposed on the trust. Although Cocciardi did not act in bad faith in this transaction, he was neglectful by failing to return to the trust the proceeds of the trust investment in the deed of trust. The trust should realize its share of the profits from the sale of the Fisher property. Its 54% interest in the sales proceeds entitles the trust to \$93,762.96, plus interest of \$99,545 from October 1985 at the rate of contract rate of 14%, which results in a total recovery of \$193,307.96 on this transaction.

10. Carbajal Transaction

In August 1985, the trust had an opportunity to invest \$40,000 in trust funds in the Carbajal property at a foreclosure sale. The sale was postponed, and the \$40,000 was redeposited into the trust account. The same amount was withdrawn again from the trust account in September 1985, at which time Cocciardi used other investors' funds to purchase the Carbajal property at a foreclosure sale for \$148,000. The purchase price was less than anticipated, and Cocciardi had available to him sufficient funds from other sources, so he did not use the trust funds as part of the purchase price. The \$40,000 was redeposited into the trust account. The Carbajal property was later resold for a profit. Plaintiffs assert that the actual sales price of \$187,500 was not the true fair market value, which they believe to be \$400,000. Plaintiffs seek a pro rata share of \$400,000. However, the trustee did not breach his duty to make trust property

1 productive by failing to invest trust assets into the Carbajal transaction because there was no
2 indication in advance that the transaction would result in a profit. The portfolio approach to
3 investment strategy by a trustee precludes the Court from holding the trustee liable for any
4 amount on the Carbajal transaction. Plaintiffs are not entitled to any recovery on this transaction.

5 **11. Tract 7761**

6 Cocciardi personally purchased 38 acres in Saratoga from O. T. Robertshaw in 1977 for
7 \$448,000. No trust funds were involved in the purchase of the property, which is referred to as
8 Tract 7761. Cocciardi gave Robertshaw a note for \$360,500. In 1979, Cocciardi and Thomas E.
9 Burke entered into an agreement to develop Tract 7761. In 1985, Burke took title to the
10 property to obtain a construction loan of \$5 million from Gibraltar Savings, but Cocciardi and
11 Burke also agreed that each would share the future profits and bear half of the costs of
12 development. The expenses of development included the construction of a buttress required by
13 the City of Saratoga. Cocciardi contributed the 25-acre landfill for the buttress, which was valued
14 between \$1 million and \$3 million.

15 In June 1986, Eaton wanted to purchase Cocciardi's interest in Tract 7761. Cocciardi
16 testified that he loaned Eaton \$47,625 from trust funds to purchase an option to buy Cocciardi's
17 interest in Tract 7761. Cocciardi testified credibly that it was upon Eaton's strong insistence that
18 he made the loan. Cocciardi used the \$47,625 to pay a portion of the note to Robertshaw. Eaton
19 never exercised the option to purchase Cocciardi's interest in Tract 7761. Plaintiffs argue that the
20 trust is entitled to impose a constructive trust on Tract 7761 based on the trust's contribution to
21 the development. However, the facts and the equities fail to support the imposition of a
22 constructive trust. The evidence is that the \$47,625 loan was not anything more than the purchase
23 price for an option that was never exercised. The evidence also indicates that Eaton would have
24 been unable to fund his share of the development costs of Tract 7761. Eaton never repaid the
25 trust, and Cocciardi did not collect from Eaton because he assumed the trust funds belonged to
26 Eaton. Therefore, Cocciardi is liable for the amount of the loan, plus interest of \$32,940.63 at the
27 legal rate of 10% from June 1986, which results in a total recovery of \$80,565.63 on this
28 transaction.

12. Tract 7700

1 In 1973, Caroline Cocciardi Eitzen, the defendant's daughter, purchased 30 acres in
2 Saratoga now referred to as Tract 7700 for \$90,000 to develop into a subdivision. Plaintiffs
3 argue that the trust is entitled to impose a constructive trust on Tract 7700. The basis of this
4 argument is that after Eaton's death in 1989, Cocciardi borrowed against the Foothill Boulevard
5 property and used a portion of the proceeds of the loan to pay development costs for Tract 7700.
6

7 Eaton originally owned the Foothill Boulevard property but conveyed it to his mother. In
8 her testamentary disposition, Murl Eaton divided the Foothill Boulevard property between her
9 three children, granting Eaton's interest to him in trust. Ann Leep and John Eaton relinquished
10 their interests in the Foothill Boulevard property to Eaton as part of the terms of settlement of the
11 probate litigation. However, the stipulated Judgment of Final Distribution of Murl Eaton's estate
12 reflects that the property was distributed to the trust rather than directly to Eaton, perhaps by a
13 scrivener's error. Because there is the suggestion of ambiguity and factual dispute regarding the
14 intention and construction of the terms of the 1976 Judgment of Final Distribution and for reasons
15 of comity, the Court declines to amend the judgment.

16 Believing that he held title to the property in which he resided, Eaton conveyed it to
17 Cocciardi by quitclaim deed in 1977. The evidence, including Cocciardi's testimony, fails to
18 support the plaintiffs' argument that the proceeds of the Guardian loan went directly into
19 development costs for Tract 7700. Cocciardi was mistaken in his belief that he owned a fee
20 interest in the Foothill Boulevard property because pursuant to the Judgment of Final
21 Distribution, Eaton had no interest to convey. However, neither the facts nor the equities support
22 the imposition of a constructive trust on Cocciardi's interest in the profits of Tract 7700 for the
23 benefit of the trust. As a result, Cocciardi is directed to transfer to the trust by quitclaim deed all
24 interest in the Foothill Boulevard property, to surrender possession, and to turn over to the
25 present trustee all keys, rental agreements, insurance documents, and any and all other indicia of
26 ownership or management.

27 With respect to damages for Cocciardi's retention of the property since March 1989,
28 California law grants the Court discretion to excuse a trustee from liability for damages if the

1 trustee acted reasonably and in good faith under the circumstances. Cal. Prob. Code § 16440.
2 Cocciardi believed in good faith that he held title to the property in 1989 when he secured the
3 Guardian loan because Eaton had conveyed it to him. In fact, Ticor Insurance Company issued a
4 title policy on the Foothill property in Cocciardi's name. The equities of the case do not justify
5 the award of additional damages upon the transfer to the trust of title in the Foothill Boulevard
6 property.

7 By consent of the parties, the Court further orders that Cocciardi shall be solely
8 responsible for repayment of the loan to the Resolution Trust Corporation (RTC), conservator for
9 Guardian Federal Savings, because he had no interest in the Foothill Boulevard property with
10 which to secure the Guardian loan, and, as a result, the deed of trust to Guardian was void.
11 Further, Cocciardi shall indemnify the trust for all damages, costs, and legal fees incurred in any
12 action brought by the RTC against the trust, which shall accede to any rights that Cocciardi may
13 have against Ticor for guaranteeing his title to the property purportedly securing the Guardian
14 loan. The Court shall retain jurisdiction to determine the amount of such indemnification.

15 **13. Bertolussi Loan**

16 In March 1986, the trust made an unsecured loan for \$16,500 to Bob Bertolussi.
17 Bertolussi repaid the loan and \$1,600 in interest in October 1986 from the proceeds of the closing
18 of an escrow on a house known as the Rucker property. Specifically, the plaintiffs contend that
19 because Cocciardi deposited the entire \$91,939.84 net proceeds of the escrow into the trust's
20 account, all of the escrow proceeds belonged to the trust. However, Cocciardi credibly testified
21 that the funds included another client's check, which was deposited into the trust account so that
22 the bank would issue cashier's checks to him without a service fee. Certainly it was ill advised for
23 Cocciardi to deposit the funds into the trust account in order to acquire cashier's checks free of
24 charge; however, Cocciardi's actions do not justify construing this transaction as a trust
25 investment in the Rucker property. The trust was fully repaid the amount of the loan with interest
26 at 17%. As a result, Plaintiffs are not entitled to any further recovery from the trustee on this
27 transaction.

28 **14. Wiebe Loan**

Cocciardi personally borrowed funds from California Commerce Bank to lend to Dave Wiebe at 14% interest. California Commerce Bank requested a \$10,000 principal reduction when Cocciardi requested an extension of that loan in November 1986. Cocciardi credibly testified that he authorized California Commerce Bank to debit that amount from his personal account at California Commerce Bank but did not instruct the bank to debit the trust account. However, California Commerce Bank inadvertently debited \$11,653.06 from the trust account. The trust has not been reimbursed. As a result, Cocciardi, as trustee, is liable for reimbursement to the trust of the \$11,653.06 with interest in the amount of \$7,574.49 at the legal rate of 10% from November 1986, which results in a total recovery of \$19,227.55 on this transaction.

15. Eitzen Loan

In December 1986, the trust made an unsecured loan of \$11,500 to Mark Eitzen. Although there is some confusion as to whether this was payment for services or a loan, Eitzen signed a declaration indicating it was a loan. Cocciardi has not sustained his burden of establishing the payment was anything other than a loan. Since the unsecured loan has not been repaid, and the trustee has a duty to pursue trust claims, Cocciardi is liable to the trust for the principal, plus interest of \$7,379.17 at the legal rate of 10% from December 1986, which results in a total recovery of \$18,879.17 on this transaction.

16. Dias Loan

In August 1987, on Eaton's urging, the trust made an unsecured loan of \$6,000 to Al Diaz. It is undisputed that Diaz repaid only \$3,000 of principal in September 1989 and that the balance has not been repaid. Because of the risk involved with a personal unsecured loan and the trustee's duty to enforce trust claims, Cocciardi is liable for the unpaid balance of \$4,250, plus interest of \$1,558.33 at the legal rate of 10% from September 1989, which results in a total recovery of \$5,808.33 on this transaction.

D. Summary of Analysis

The following is a summary by transaction of the amounts for which Cocciardi is liable for repayment to the trust.

	<u>TRANSACTION</u>	<u>UNPAID BALANCE</u>	<u>INTEREST THROUGH 5/31/93</u>
1			
2	1. La Selva	-0-	-0-
3	2. Siraky	3,000.00	1,520.00
4	3. Russo	650.00	1,408.86
5	4. Cocciardi Corp.	-0-	-0-
6	5. Martinez		
7	a. \$35,000	13,650.00	15,834.00
8	b. \$29,000	2,000.00	3,428.33
9	6. Bryce	3,424.50	2,425.69
10	7. McAlpine		
11	a. Golfview	6,365.00	5,792.15
12	b. \$22,000	22,000.00	21,340.00
13	8. Ward		
14	a. \$9,420	9,420.00	11,775.00
15	b. \$16,500	19,800.00	17,325.00
16	9. Bloch		
17	a. \$10,000	10,000.00	8,000.00
18	b. \$43,000	60,000.00	52,650.00
19	c. \$43,000	93,762.96	99,545.00
20	10. Carbajal	-0-	-0-
21	11. Tract 7761	47,625.00	32,940.63
22	12. Tract 7770	-0-	-0-
23	13. Bertolussi	-0-	-0-
24	14. Wiebe	11,653.06	7,574.49
25	15. Eitzen	11,500.00	7,379.17
26	16. Dias	<u>4,250.00</u>	<u>1,558.33</u>
27		\$319,100.52	\$290,496.65
28			

E. Trustee Compensation

At Eaton's insistence, Cocciardi received a total of \$19,000 in trustee compensation in 1987. Otherwise, he has not been compensated for his services in administration of the Murl

1 Eaton Trust and is not requesting additional compensation. A trustee is entitled to reasonable
2 compensation for services. Cal. Prob. C. § 15681; In re Estate of Gump, 128 Cal. App. 3d 111,
3 116 (Cal. App. 1982). While the Court may properly consider comparable or customary charges
4 for such services in the private sector, it is not obliged to do so and is free to consider other
5 relevant factors, including the success or failure of the trustee's administration of the trust. Id.
6 Given the length of time of his services, that he acted in good faith, and that the trust will be made
7 whole by this ruling, as well as compensated amply for the investments, Cocciardi is not required
8 to disgorge the compensation previously received.

9 **F. Dischargeability of the Debtor's Liability for Breach**

10 Plaintiffs have sought a determination that Cocciardi's debt to the trust is non-
11 dischargeable under Bankruptcy Code Sections 523(a)(2), (a)(4), and (a)(6). Because the Court
12 finds that the debt to Plaintiffs is non-dischargeable under Section 523(a)(4), the Court need not
13 address Sections 523(a)(2) and (a)(6).

14 To except a debt from discharge for fraud or defalcation while acting in a fiduciary
15 capacity under section 523(a)(4), a plaintiff must establish that a fiduciary relationship existed and
16 that a defalcation occurred. In re Chapman, 125 Bankr. 284, 286-87 (Bankr. S.D. Cal. 1991).
17 The fiduciary relationship must have been created before the act of wrongdoing. Ragsdale v.
18 Haller, 780 F.2d 794, 796 (9th Cir. 1986). Statutory trusts are included in the types of fiduciary
19 relationships contemplated under § 523(a)(4). In re Pedrazzini, 644 F.2d 756, 758 (9th Cir.
20 1981). The California Probate Code provides that a trustee is a fiduciary in the exercise of his or
21 her powers as a trustee. Cal. Prob. C. § 16202. Cocciardi thus occupied a fiduciary role for
22 purposes of non-dischargeability under § 523(a)(4).

23 Establishing that a defalcation occurred may be satisfied if the fiduciary failed to account
24 for money or property that has been entrusted to the fiduciary. In re Baird, 114 Bankr. 198, 204
25 (Bankr. 9th Cir. 1990). Liability under § 523(a)(4) also includes innocent as well as intentional or
26 negligent defaults so as to reach the conduct of all fiduciaries who are short in their accounts. Id.
27 Plaintiffs have sufficiently established that Cocciardi has breached his fiduciary duty as trustee of
28 the Murl Eaton Trust to justify the exception from discharge of his debt for reimbursement to the

trust.

IV. CONCLUSION

For the reasons stated, the Court concludes that Cocciardi breached his fiduciary duty as trustee of the Murl Eaton Trust and is liable to the plaintiffs for \$609,597.17, which is non-dischargeable pursuant to Bankruptcy Code Section 523(a)(4). The plaintiffs shall prepare an appropriate judgment to submit to the Court.